IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH " A "

BEFORE SHRI ABRAHAM P GEORGE, ACCOUNTANT MEMBER AND
SHRI VIJAY PAL RAO, JUDICIAL MEMBER

I.T.(T.P) A. No.568/Bang/2012 & C.O. No.31/Bang/2015 (Assessment Year : 2007-08)		
M/s. Luwa India Pvt. Ltd. No.95, Industrial Suburb, II Stage, Tumkur Road, Yeshwanthpura, Bangalore-560 022 PAN AAACL 3106B	Vs.	Asst. Commissioner of Income Tax, Circle 11(5), Bangalore.
Appellant		Respondent.

I.T.(T.P) A. No.581/Bang/2012
(Assessment Year : 2007-08)
(By Revenue)

Assessee By : S/Shri P.K. Prasad & Umashankar, Advocates.
Revenue By : Dr.P.K. Srihari, CIT (D.R.)

Date of Hearing : 4.7.2016.
Date of Pronouncement : 26.8.2016.

O R D E R

Per Shri Vijay Pal Rao, J.M. :

These cross appeals and Cross Objection by assessee are directed against the order dt.28.2.2012 of Commissioner of Income Tax (Appeals) for the Assessment Year 2007-08.

2. The assessee is engaged in the manufacturing of textiles machines for textile manufacturers in India. During the year under consideration the assessee has reported its financial results as well as international transactions which were reproduced by the TPO as under :

Financials of the company for the A.Y. 2007-08.

(In Rs.)

Operating Revenues	81,09,82,954
Expenditure	75,73,77,965
Profit	5,36,04,989
PBIT / Expenditure	7.07%
PBIT / Income	6.61%

International transactions :

		Paid (Rs.)	Received (Rs.)
a.	Import of raw materials, spare parts and components	12,33,82,533	
b.	Purchase of office equipments	33,097	
c.	Export of components of Textile machinery.		20,89,409
d.	Payment of Royalty	4,30,33,562	
e.	Management Services	99,06,990	
f.	Reimbursement of Expenses	3,47,291	

The assessee has also paid royalty of Rs.4,30,33,562 to its Associated Enterprises (AE) i.e. Luwa IP. The assessee has bench marked its international

transactions on consolidated basis by considering the purchases, royalty payment, sales as composite international transactions by applying TNMM at enterprise level. The TPO segregated the royalty transaction as an independent international transaction and applied benefit test to question the justification of payment of royalty by the assessee to AE. The TPO was of the view that the assessee has failed to prove that it has obtained the benefit by receiving the alleged intangible/know how against the said payment of royalty. Finally the TPO held that the royalty payment cannot be allowed because the assessee has failed to demonstrate the receipt of technology and consequential benefit of economic or commercial value. Accordingly, the TPO determined the ALP of royalty at NIL. On appeal, the CIT (Appeals) overturned the finding of the TPO and held that the assessee has produced the relevant record including the agreement under which the technical know how was granted to the assessee against the payment of royalty. The CIT (Appeals) has also accepted the bench marking of the international transactions by considering all the transactions and accordingly directed the A.O./TPO to compute the ALP of consolidated transactions with the AE and then make TP adjustment under Section 92CA of the Income Tax Act, 1961 (in short 'the Act') in respect of the turnover of the assessee at entity level. While passing the impugned order, the CIT (Appeals)

has also rejected one of the comparables from the set of comparables selected by the TPO and also included two more comparable companies from the TP Study Analysis of the assessee which was rejected by the TPO by applying turnover filter. Thus both the assessee as well as revenue are aggrieved by the impugned order of the CIT (Appeals) and filed the respective appeals as well as Cross Objection by the assessee.

3. First we take up the appeal filed by the revenue wherein the revenue has raised the following grounds :

"" 1. The order of the CIT (Appeals) in so far as it is prejudicial to the Revenue, is opposed to law and facts and circumstances of the case.
2. The learned CIT (Appeals) has erred in not upholding that royalty is an independent transaction which should not be aggregated with other international transactions, as ALP of each international transactions should be determined separately so long it is possible to segregate the transaction from the other international transaction.
3. Several international transactions of different nature if aggregated and TNMM is applied, then it is difficult to determine the ALP of the international transactions of similar nature because of cross subsidisation. Therefore, the learned CIT (Appeals) should have upheld the rejection of TNMM and application of CUP by the TPO as CUP method is considered to the MAM in case of royalty transaction.
4. The learned CIT (Appeals) has erred in not upholding the rejection of TNMM and application of CUP by the TPO as CUP method is considered to the MAM in case of royalty transactions.
5. The learned CIT (Appeals) has erred in treating the payment of royalty at Arm's Length without appreciating the findings of the TPO that there was no benefit accrued to the assessee by way of payment to royalty to the AE.

6. The learned CIT (Appeals) has erred in holding that the assessee is eligible for a standard deduction of 5% from the ALP under the proviso to section 92C(2) of the IT Act, 1961.

7. The appellant craves leave to add, to alter, to amend or to delete any of the grounds that maybe urged at the time of hearing of appeal."

4. The only issue raised in the revenue's appeal is regarding the aggregation of all the international transactions including royalty for the purpose of determining the ALP.

5. We have heard the learned D.R. as well as learned A.R. and considered the relevant material on record. The learned Departmental Representative has pointed out that the assessee's other international transactions are only purchases from the AE and only insignificant amount of sale in comparison to the total purchase of the assessee which is more than Rs.623 Crores. Therefore the royalty payment cannot be aggregated with the other international transactions for the purpose of determining the ALP. He has further contended that the royalty has been paid under a separate agreement and therefore has no relation with the purchases of the assessee from its AE. Thus the learned Departmental Representative has submitted that this transaction of payment of royalty and the transaction of purchases with the AE are not closely related transaction but are separate and independent international transaction

therefore these cannot be treated as closely linked transaction for the purpose of transfer pricing adjustment. The learned Departmental Representative has forcefully contended that the aggregation and clubbing of transactions in the case of the assessee are not permitted with the transactions that are not closely linked transactions which cannot be applied in this case.

5.1 On the other hand, the learned Authorised Representative has submitted that the royalty is paid to the AE in respect of the know how which is inevitable for the manufacture functions of the assessee therefore without the know how supplied by the AE, the assessee cannot carryout its business activity of manufacturing of textile machinery. He has further contended that in the absence of any uncontrolled comparable price, the only appropriate method is TNMM and therefore the assessee has clubbed all the transactions with AE for the purpose of determining the ALP which has been accepted by this Tribunal in various decisions. He has relied upon the decision of Tribunal dt.27.10.2014 in case of M/s. Toyota Kirloskar Motors P. Ltd. in IT(TP)A No.1356/Bang/2010 and submitted that the Tribunal in identical facts and circumstances held that it is not practically possible to find an intangible asset transfer to the assessee against the payment of royalty as a comparable as similar intangible to independent enterprises is not easily available. Therefore

where uncontrolled transactions are not available especially ALP of royalty paid may not be a straight forward exercise. In such situation the perfect approach is indirectly benchmarking royalty payment by comparing the profit margin of tested party after payment of royalty with the profit margin of the uncontrolled comparable. The learned Authorised Representative has submitted that when there is no comparable uncontrolled price is available to apply the CUP method, then the only method available for bench marking international transactions for payment of royalty is TNMM. He has further pointed out that in the subsequent assessment year, the TPO has accepted the bench marking of payment of royalty by applying TNMM as MAM.

6. We have considered the rival submissions as well as the relevant material on record. As far as the justification for payment of royalty and applying the benefit test, we find that the TPO was not justified to adopt such approach in determining the ALP of royalty payment when the assessee has produced the agreement between the assessee and the AE under which license was granted to the assessee to use technical know how belonging to the AE for the purpose of manufacturing activity. We find that as per the agreement, the AE has granted license to the assessee to use all its process, design, drawing and other technology involved in the manufacturing activity of the assessee. Therefore to

this extent of the payment of royalty against the transfer of technical know how, we do not find any error or illegality in the order of the CIT (Appeals). The relevant record and evidence was duly produced by the assessee before the authorities below to establish that the royalty in question was paid against the use of right to use of the technical know how belonging to the AE. Accordingly, we hold that the determination of ALP by the TPO cannot be considered as NIL. Even otherwise the jurisdiction of the TPO is to determine the ALP by testing the same with uncontrolled comparable price and not to examine the allowability of the claim by applying the benefit test or the conditions as provided under Section 37(1) of the Act. However, in the present case the purchase and raw-material from AE consist of Rs.123 Crores as against the total purchases of Rs.623 Crores. The export components to the AE is only Rs.20,89,409 which is insignificant in comparison to the total sale of the assessee. Therefore the TNMM cannot be applied as MAM for determining the ALP of royalty payment in question but we find that neither the TPO nor the assessee was able to find such uncontrolled comparable case where an identical intangible has been transferred by the party to a non-related party against the payment of royalty. Thus in such a situation the TNMM being the residual method which has to be applied as MAM for determining the ALP. We

find that in a number of cases the Tribunal has taken this view by considering the peculiar facts where a comparable price is not available for the purpose of applying the CUP method. In the recent decision of the Tribunal dt.30.6.2016 in case of **DCIT Vs.Toyota Kirloskar Motors P. Ltd.** in **IT(TP)A No.16/Bang/2015** has held in paras 12 & 13 are as under :

> *" 12. We have heard the learned Authorised Representative as well as learned Departmental Representative and considered the relevant material on record. At the outset we note that an identical issue has been considered by this Tribunal in assessee's own case for the Assessment Years 2003-04, 2007-08 and 2008-09. We further note that the TPO for the Assessment Year 2012-13 has accepted the manufacturing and trading segment as integrated and combined transaction for the purpose of determining the ALP under TNMM.*
>
> *13. For the Assessment Year 2003-04, the Tribunal vide its order dt.27.11.2012 reported in 28 taxman.com 293 as held in para 14.5.2 as under :*
>
> *" 14.5.2 Taking into consideration the submissions made and the facts and circumstances of the case, we agree with the submissions of the learned counsel for the assessee. While it is true that function, assets and risks of the trading and manufacturing segments generally differ, however circumstances may warrant combining both of them. It is only in the specific facts of the case that the combining of both segments is advisable. In the instant case of the assessee, the sale of spare parts is triggered as a result of the manufacturing activities, including warranty commitments. Therefore, we are of the view that it would not be in the fitness of things for the sale of spare parts and components to be considered in isolation from the sale of manufactured vehicles. This view is supported by the OECD T.P. Guidelines, 2010, relied on by the assessee. This view is also buttressed by the fact that the comparable companies are also trading in spare parts and components. On a overall consideration, it can be concluded that trading in spare parts is closely inter-linked with the manufacturing segment of the assessee. We are of the view that no meaningful purpose would be served in segregating the trading and*

manufacturing segments, particularly when the assessee and the comparable companies are at par with regard to the nature and scale of combined activities. Needless to add that this finding / decision by its very nature has to be case-specific and year-specific as the decision is based on the facts and circumstances of this particular case and of this particular year and is not to be construed as laying down the principle in this regard. We, therefore, direct the Assessing Officer / TPO to compute the ALP at the entity / enterprise level by combining the trading and manufacturing segments."

Thus it is clear that the Tribunal was of the view that in the fitness of things and in the facts and circumstances of the case where the comparable companies are also trading in spares and components then it would be appropriate to combine the trading and manufacturing segments for computing the ALP. A similar view was taken by the Tribunal after having a detailed discussion on the issue for the Assessment Year 2007-08 reported in 33 ITR (Trib.) 700 and concluded in para 46 as under :

" 46. We have already seen in para 9 of this order that the TPO has arrived at the bifurcation of the manufacturing and trading segmental operating results. In view of our conclusions that the trading and manufacturing segments are interlinked and therefore a combined transaction approach has to be adopted, we combine the results so arrived at by the TPO, which is given in para 9 of this order. If the segmental results are combined, the operating revenue of the assessee would be 3767.91 crores and the operating profit would be Rs.94.34 crores. Thus, the operating profit margin on sales would be 2.517."

Again for the Assessment Year 2008-09 in assessee's own case vide order dt.14.8.2014, the Tribunal has taken the same view. Following the earlier orders of this Tribunal, we direct the A.O./TPO to compute the ALP by considering the trading and manufacturing segments as interlink and combined transaction."

In the case on hand it was brought to our notice that the TPO has accepted the TNMM as MAM for determining the ALP in respect of the royalty payment

being aggregated transaction along with the other international transactions of the assessee. Therefore keeping in view of the facts and circumstances of the case, we do concur with the view of the CIT (Appeals) on this issue. Accordingly, the appeal of the revenue is dismissed.

C.O. No.31/Bang/2015

7. The assessee has raised the following grounds in C.O. :

1. *" That the contention of the Revenue is bad in law by holding that royalty is an independent transaction and should not be aggregated with other international transactions and considering Comparable Uncontrolled Price ("CUP") method as the most appropriate method. The Revenue thereby erred in not accepting the order of the Commissioner of Income Tax – Appeals ["CIT(A)"] wherein the CIT(A) has considered Transactional Net Margin Method ("TNMM") at the entity level as the most appropriate method.*

2. *That the Revenue has erred by holding that no benefit has been accrued to the Respondent by way of payment of royalty.*

3. *That the contention of the Revenue is bad in law by holding that the CIT(A) erred in providing the benefit of 5% standard deduction to the Respondent."*

That the Respondent craves leave to add to and/or to alter, amend, rescind, modify the grounds herein above or produce further documents before or at the time of hearing of this Appeal.

8. As regards the application of TNMM as MAM, in view of our finding in the appeal of the revenue becomes infructuous. However, we direct the TPO to consider the adjustment only by considering the international transactions of the assessee and therefore the proportionate cost which includes the raw

material purchase and royalty can be considered for the purpose of adjustment. The benefit of second proviso to section 92C is also directed to be considered by the TPO.

9. The assessee in its appeal has raised the following grounds :

1. *The order of Commissioner of Income-tax (A) in so far as prejudicial to the interest of the appellant is bad in law and to that extent the same is not sustainable in the eye of law.*

2. *The Commissioner (A) having accepted the proposition of the TPO that the exclusion of certain comparables being appropriate, ought to have refrained from retaining such excluded comparables while determining the Arithmetic Mean of Margins.*

3. *The Commissioner (A) erred in computing the benefit of lower range of 5% provided under proviso to Section 92C(2) of the Act in determining the arm's length price.*
4. *Without prejudice, the Commissioner (A) having rejected loss making companies as non-comparables ought to have rejected the higher profit companies like Lakshmi Machine Works Ltd., Lois Starlinger Ltd., and Bharat Bobbins Ltd., also, for the purpose of determining mean margin.*
5. *The Commissioner (A) erred in making the transfer pricing adjustment even for the non-associated enterprise transactions carried out by the appellant.*
6. *Without prejudice, the Commissioner(A) ought to have appreciated that when the higher margin companies and those cases which could not be compared with the appellant company are excluded from the comparable study, the operating profit margin would fall within (+/-) 5% range and thereby the ALP declared by the appellant would be at arms length and therefore there was no further adjustment called for.*
7. *The Commissioner (A) ought to have deleted the interest u/s.234B, 234C &z, 234D of the Act.*

8. *Without prejudice the adjustment as sustained by the Commissioner (A) is contrary to the facts, pleadings*

and circumstances of the case and ought to have reduced substantially.

9. *For these and other grounds that may be urged at the time of hearing of the appeal the appellant prays that the appeal may be allowed."*

10. The assessee has also raised additional grounds as under : Repr addl. Grounds.

1. *" That the Learned Commissioner of Income-tax (Appeals)-IV, Bangalore ('Ld. CIT(A)') erred in suo moto disallowing the turnover filter applied by the Learned Transfer Pricing Officer-IV ('Ld. TPO') thereby accepting high margin companies namely* ***Lakshmi Machine Works Ltd*** *and* ***LohiaStarlinger Ltd****.*

2. *That the Ld. TPO/ Ld. CIT(A) erred in excluding* ***Instrumentation Ltd*** *as a comparableon the ground that it has consistently incurred losses for three years (i.e., Financial Year ('FY') 2004-05, FY 2005-06 and FY 2006-07), whereas it has earned profit during the FY 2006-07.*

3. *That the Ld. TPO/ Ld. CIT(A) erred in including the non-operating income while arriving at the segmental margin of* ***18.17%*** *in case of* ***Nesco Ltd."***

11. In the additional grounds, the assessee is seeking exclusion of two comparable companies included by the CIT (Appeals) in the list of comparables which were rejected by the TPO on turnover basis.

12. We have heard the learned Authorised Representative as well as learned Departmental Representative and considered the relevant material on record on the admissibility of the additional grounds. Ld. A.R. has relied upon various decisions including the decision of this Tribunal dt.23.11.2015 in the case of

Flextronics Technologies India Pvt. Ltd. reported in 65 taxman.com 258 as well as the decision in the case of **M/s. Online India Pvt. Ltd.** Dt.18.3.2015 in IT(TP)A No.1036/Bang/2011. The learned Authorised Representative has also relied upon the decision of the Special Bench of ITAT, Chandigarh in the case of Quark Systems Ltd. 38 SOT 307 and submitted that even if the assessee has taken a particular company as comparable in the TP study, the assessee is entitled to point out before this Tribunal that the said enterprise has wrongly been taken as comparable. The learned Authorised Representative has contended that the TPO has not applied the employee cost filter and therefore some of the companies selected by the TPO failed the test of employee cost filter of 25%. In support of his contention, he has relied upon the decision of the co-ordinate bench of this Tribunal in the case of M/s. Google India Ltd. 29 taxman.com 412 and submitted that the Tribunal has held that the employee cost filtor of 25% should be applied in the ITES segment also. As regards the RPT filter of 15%, the learned Authorised Representative has submitted that in a series of decisions the Tribunal has taken a consistent view that the RPT filter should not be more than 15% and therefore the companies which are having more than 15% related party transactions should be excluded from the list of comparables selected by the TPO.

13. On the other hand, the learned Departmental Representative has submitted that when the assessee selected these companies as comparables in the TP study, the assessee cannot be permitted to raise the objections against the comparability of those companies. He has further submitted that if the objections raised by the assessee is accepted then it will reverse the entire process of determination of ALP conducted by the TPO. He has further contended that neither the assessee nor the TPO has applied any employee cost filter therefore at this stage, the assessee cannot be allowed to raise such an objection which requires investigation of new facts in respect of the companies selected by the TPO as well as by the assessee. As regards the RPT filter, the learned Departmental Representative has contended that the TPO has applied 25% which was not objected by the assessee either before the TPO or before the CIT (Appeals) and therefore at this stage the assessee cannot be allowed to raise fresh objections which were not raised before the authorities below.

14. We have considered the rival submissions as well as the relevant material on record. As regards the objections raised by the assessee against the companies namely **Lakshmi Machine Woprks Ltd., Lohia Starlinger Ltd., Instrumentation Ltd.** and **Nesco Ltd** we find that this Tribunal in a series of

decisions has examined the functional comparability of these companies and therefore once it has been held that these companies cannot be regarded as functionally comparable then even if these companies has been selected in the TP Study, the assessee cannot be precluded from raising an objection against these companies which are found to be not comparable. This view is supported by the decision of the Chandigarh Special Bench of this Tribunal in the case of DCIT Vs. Quark Systems Pvt. Ltd. 38 SOT 307 in paras 30 and 38 as under :

ñ**30.** Learned special counsel for the Revenue Shri Kapila has vehemently argued that "Datamatics" was taken as one of the comparables by the taxpayer and no objection to its inclusion was raised before the TPO or before the learned CIT(A) in appeal. Therefore, the taxpayer should not be permitted to raise additional ground and ask for exclusion of the above enterprise in the determination of the average margins. We are unable to accept above contention. In the first place, these are initial years of implementation of transfer pricing legislation in India and taxpayers as well as tax consultants were not fully conversant with this new branch of law when proceedings were initiated or even at appellate stage. Besides, Revenue authorities, including TPO were required to apply statutory provisions and consider for purposes of comparison functions, assets and risks (turnover), profit and technology employed by the tested party and other enterprises taken as comparable. Statutory duty is cast on them to undertake above exercise. This has not been done in this case. We would only say that *prima facie*, as per the material, to which reference has been drawn by Shri Aggarwal, Datamatics does not appear to be comparable. Even if the taxpayer or its counsel had taken Datamatics as comparable in its T.P. audit, the taxpayer is entitled to point out to the Tribunal that above enterprise has wrongly been taken as comparable. In fact there are vast differences between tested party and the Datamatics. The case of Datamatics is like that of "Imercius Technologies" representing extreme positions. If Imercius Technologies has suffered heavy losses and, therefore, it is not treated as comparable by the tax authorities, they also have to consider that the Datamatics has earned extraordinary profit and has a huge turnover, besides differences in assets and other characteristics referred to by Shri Aggarwal. The Tribunal is a fact-finding body and, therefore, has to take into account all the relevant material and determine the question as per the statutory regulations."

38. Accordingly, on facts and circumstances of the case, we hold that taxpayer is not estopped from pointing out that Datamatics has wrongly been taken as comparable. While admitting additional ground of appeal raised by the assessee to require us to consider whether or not Datamatics should be included in the comparable, we make no

comments on merit except observing that assessee from record has shown its *prima facie* case. Further claim may be examined by the AO. This course we adopt as objection to the inclusion of Datamatics as comparable has been raised now and not before Revenue authorities. Therefore, we deem it fit and proper to remit the matter to the file of the AO for consideration of claim of the taxpayer and make a *de novo* adjudication of the ALP after providing reasonable opportunity of being heard to the assessee. We order accordingly."

Thus in view of the matter that the functional comparability has already been examined by this Tribunal, we admit the additional ground raised by the assessee regarding functional comparability of these companies for deciding the same on merits.

Thus in the original grounds as well as the additional grounds, the assessee is seeking exclusion of two companies as under :

(i) Laksmi Machine Works Ltd. and

(ii) Lohia Starlinger Ltd.

The assessee is also seeking the correct operating margin income in respect of one company i.e. Nesco Ltd.

15. The TPO while computing the ALP in respect of the international transactions of purchase of raw material and sales export to the AE selected 9 companies as under :

Company Name	*Year*	*Sales*	*PBIT / Sales*
Lagan Engineering Co. Ltd.	*2007-08*	*14.27*	*6.66*
Sirdar Carbonic Gas Co. Ltd.	*2007-08*	*5.1*	*24.90*

Naval Technoplast Inds. Ltd.	*2007-08*	*26.14*	*5.97*
Lakshmi Automatic Loom Works Ltd.	*2007-08*	*39.38*	*4.24*
Bharat Bobbins Ltd.	*2007-08*	*11.66*	*31.56*
Veejay Lakshmi Engg. Works Ltd.	*2007-08*	*90.45*	*11.50*
Nesco Ltd.	*2007-08*	*69.7*	*18.17*
Ahmedabad Victoria	*2007-08*	*5.15*	*6.41*
Anup Engineering	*2007-08*	*36.2*	*6.38*
		Average	*12.86*

16. Though the TPO determined the ALP of the comparable prices being mean margin at 12.86% in comparison to the assessee's profit margin at 6.61% however the said adjustment is less than the adjustment in respect of the royalty payment of Rs.4,13,33,562. Therefore the TPO has not made any adjustment on account of other international transactions. Now the assessee is seeking exclusion of two comparables and correct margin of third one. We will deal one by one as under :

(i) **Laxmi Machine Works Ltd.**

17.1 The learned Authorised Representative of the assessee has submitted that the turnover of the assessee is Rs.86 Crores whereas the turnover of the Laxmi Machine Works Ltd. is Rs.1745 Crores. Therefore the said company

cannot be compared with the assessee having benefit of economies of scale in the manufacturing sector. In support of his contention, he has relied upon the decision of the Mumbai Bench of the Tribunal dt.28.2.2013 in the case of Capgemini India Pvt. Ltd. (ITA No.7861/Mum/2011) and submitted that while considering the issue of turnover filter in case of ITES the Tribunal observed that the concept of economy of scale is relevant to manufacturing concerns, which have high fixed assets and, therefore, with the rise in volume, cost per unit of the product decreases, which is the reason of increase in margin as scale of operations goes up because with the same fixed cost there is more output when the turnover is high. Thus the learned Authorised Representative has contended that by applying any parameter this company cannot be considered as a good comparable.

17.2 On the other hand, the learned Departmental Representative has relied upon the orders of authorities below and submitted that there is no evidence to show that the high turnover has an advantage of high margin rather the high turnover companies can earn more income in terms of the volume but not the high profit margin.

17.3 We have considered the rival submissions as well as the relevant material on record. The TPO rejected this company by applying the turnover

filter of Rs.1 Crore to Rs.2 Crores. Though we do not concur with the view of the TPO of applying this turnover filter of Rs.1 Crore to Rs.200 Crores because of inherent defective consequence and results of such a standard slab applied in the case however, we are of the view that in case of manufacturing sector, the turnover is a relevant factor for functional comparability of the companies as the economies of scale, bargaining power, more skilled employees and higher risk capacities are attached to the high turnover and further the high fixed assets and fixed costs is spread over to the high turnover giving the benefit of economies of scale. Accordingly keeping in view of the turnover of the assessee at 86 Crores the company having Rs.1745 Crores turnover cannot be considered as a good comparable. Hence we direct the TPO to exclude this company from the list of comparable.

(ii) **Lohia Starlinger Limited.**

18.1 The turnover of this company is Rs.309 Crores in comparison to the turnover of the assessee at Rs.86 Crores though there is a difference in the turnover of the two companies however it is not possible to find out the comparable company with the identical turnover and therefore the tolerance range is to be applied for such criteria of turnover.

18.2 The learned Authorised Representative of the assessee has submitted that a three time multiple on higher and lower limit may be applied for turnover while selecting the comparable companies. Having considered the facts and circumstances of the case we are of the view that when the assessee accepted turnover filter applied by the TPO at Rs.1 Crore to Rs.200 Crores then a multiple of 5 to the assessee's turnover as an upper and lower limit of the turnover of the comparable companies can be applied and accordingly a company having Rs.430 Crores of the upper side and Rs.17 Crores on the lower side of the turnover can be applied for selecting the comparable. Therefore this company viz. **Lohia Starlinger Ltd**. falls within the tolerance range of 5 times turnover of the assessee. Since we have applied the criteria of 5 times turnover of the assessee for selecting the comparable companies of both higher and lower side therefore the TPO is directed to apply this criteria to all other comparable companies in the list of comparables.

(iii) **Nesco Limited**.

19.1 The limited grievance of the assessee in respect of this company is the incorrect profit margin considered by the TPO. The learned Authorised Representative of the assessee has referred to the Annual Report of this company and submitted that the TPO has considered incorrect profit margin at

18.17% whereas the correct profit margin of this company is only 7.77%. thus the learned Authorised Representative has submittd a suitable direction may be given to the TPO.

19.2 The learned D.R. has objected to the plea of the ld. A.R. and contended that this fact has not been pointed out before the CIT (Appeals) nor before the Assessing Officer/TPO.

19.3 We have considered the rival submissions as well as the relevant material on record. Prima facie, we find that the profit margin of this company for the engineering segment is 7.77% instead of 18.17%. However, we are of the view that this fact is to be verified by the TPO. Accordingly, we set aside this issue to the record of A.O./TPO for limited purpose of verification of the correct profit margin of this company in respect of engineering division segment. We further make it clear that the TPO shall consider only segmental data of this company relating to the engineering division of the company.

20. We have excluded one of the comparable company from the set of comparables and also set aside one company for verification of correct margin as well as applying the five multiple of turnover of the assessee in respect of the comparable companies on both higher and lower range. Therefore the TPO/A.O is directed to recompute the ALP by applying TNMM.

21. In the result, the appeal of the revenue is dismissed and the appeal of the assessee is partly allowed.

Order pronounced in the open court on 26th day of Aug., 2016.

Sd/-	Sd/-
(ABRAHAM P GEORGE)	**(VIJAY PAL RAO)**
Accountant Member	Judicial Member

*Reddy gp

Copy to :

1. Appellant
2. Respondent
3. C.I.T.
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard File.

By Order

Asst. Registrar, ITAT, Bangalore